

This record is a partial extract of the original cable. The full text of the original cable is not available.

C O N F I D E N T I A L SECTION 01 OF 03 ABUJA 001070

SIPDIS

E.O. 12958: DECL: 05/09/2014

TAGS: [PGOV](#) [EPET](#) [ECON](#) [EFIN](#) [NI](#)

SUBJECT: STRIKE WAS MINOR SETBACK FOR GASOLINE

DEREGULATION, LITTLE OTHER IMPACT ON ECONOMIC REFORM

REF: ABUJA 1054 AND PREVIOUS

CLASSIFIED BY AMBASSADOR JOHN CAMPBELL FOR REASONS 1.5 (b&d).

1. (C) Summary: The strike and rollback of prices are a temporary setback for gasoline deregulation, similar to the other rollbacks on price and the fuel tax over the past year. The GON likely will regroup and raise the basic pump price again in a few months, as it has done over the past year from N34 per liter last June to the N50-52 range before the latest strike and the N40-42 after it. The GON appears intent on continuing in this herky-jerky fashion toward ending the gasoline subsidy, and if the subsidy diminishes over time it will have only a marginal effect on the rest of the economic reform policy. End Summary.

NNPC'S GASOLINE SUBSIDY

2. (C) The Nigerian National Petroleum Corporation (NNPC) has been complaining loudly about the deleterious effect of fuel subsidization. NNPC Group General Manager Barkindo called for a (Naira) N70/liter price, telling Econoff June 14 that the price rollback was unsustainable. Barkindo said GON has wanted to make NNPC "fend for itself," operating in a competitive manner, generating its own revenue, and paying taxes as well as shareholder dividends to the GON. Two Central Bank (CBN) Deputy Governors echoed that sentiment to Econoff, noting that fuel deregulation is one plank of the NEEDS development program, and that deregulation was also necessary to free resources for building infrastructure and widening the productive base of the economy.

3. (C) Their case appears a bit overstated, given the mechanics of how NNPC subsidizes gasoline imports. The GON allocates 445,000 bpd to NNPC for domestic use, only a paper transaction of the NNPC's own oil. NNPC Senior Assistant Akani told Abuja Econ Specialist that 200,000 bpd (around 45 percent) of that domestic allocation goes to Nigerian refineries and becomes gasoline sold at less than the cost. The other 245,000 bpd is sold in the international market, and the revenue from the sales is used to import refined products for local consumption. The domestic allocation crude is accounted by the GON as being bought from, and then sold to, NNPC at a price a reliable source recently told Lagos Econoff was USD 28/bbl. Whatever of the domestic allocation crude NNPC then sells on the international market at USD 38/bbl, for example, yields some USD 4.45 million for buying gasoline.

4. (SBU) NNPC tells us domestic gasoline consumption is about 30 million liters/d. The 45 percent produced by GON refineries means 16.5 million liters/d must be imported. NNPC claims the landed cost per liter is about N50 (approx. USD 0.37), but it sells to marketers at N38.5, a loss of about N 11.50/liter. Multiplying that loss of N11.50 by imports of 16.5 million liters means the subsidy is some N190 million per day (about USD 1.4 million). Subtracting this from the revenue NNPC makes off selling that 55 percent of its domestic allocation abroad (USD 4.45 million), and not taking into account Akani's assertion that domestically refined fuel is sold at less than cost, we arrive at around USD 3 million per day in profits for NNPC.

5. (C) If NNPC is not losing money, the GON is losing that USD 4.45 million as an opportunity cost in the sense that it could otherwise go into the budget as revenue. Certainly the GON is not telling anyone how the NNPC subsidy, necessary for importing gasoline at a higher price than NNPC sells it to retailers, works. (Comment: If all of Nigeria's refineries were fully operational, all of the NNPC domestic crude allocation would be refined domestically and NNPC's opportunity for arbitrage by selling most of the domestic crude allocation abroad would no longer exist. This arbitrage may be one reason why there has been no serious effort to put Nigeria's refineries in working order. End Comment.)

ECONOMICALLY SUSTAINABLE?

16. (SBU) Whether or not the gasoline subsidy is financially sustainable depends on several factors, including the time at

which the subsidies are paid, the international price for gasoline, the quantity of gasoline imported (an inverse function of domestic refinery output), and the volume and price of the crude oil on international markets. The subsidy may well be sustainable, even when retailers are selling gasoline as low as the N38 base pump price, since international gasoline prices are likely to decline in late summer as vacations end and Iraqi exports and refining come on line. Of course, reduced crude oil prices would reduce the amount available to pay the subsidy on gasoline, unless the arbitrary GON-internal pricing of the crude was lowered too.

SUSTAINABLE AS POLICY?

17. (C) Most Nigerians are amazingly and willfully ignorant about the economics of gasoline deregulation. Gasoline should be cheap because Nigeria is an oil producer, in their view, and cheap prices has meant in practice keeping the price wherever it was last time they went to the pump. Nigerians in general are also skeptical of gasoline price reforms pursued by the GON, particularly since past raises were supposed to be used for infrastructure investments that have never materialized. Most Nigerians believe fuel price deregulation favors a small group of people, namely who possess easy access to foreign exchange and illicit funds. In the obvious sense that deregulation has not been finished, that part of the GON's economic reform policy has not been accomplished and faces a popular challenge.

18. (C) It would be a mistake, in our view, however, to interpret the continuation of fuel subsidies as proof that the GON is not committed to economic reform. This would be taking a small part of the picture and extrapolating it to the whole. Nigeria's reform blueprint, the National Economic Empowerment and Development Strategy (NEEDS), encompasses many reform measures, and the removal of the subsidy on gasoline is but one of them. Backpedaling on gasoline price levels has been common in Nigeria's recent history, and those prices are likely to go up stealthily again once the strike is a few months past.

19. (C) Although it is certainly not intended, continuing the subsidies on fuel actually has some short-term marginal benefits for the economy which redound to the benefit of reform efforts. Nigeria has no viable rail system or viable electrical grid. Everything in Nigeria moves by motor vehicle and much electricity is generated by private diesel-fueled generators, so lower fuel prices act as a buffer on already problematic inflation. Agricultural development benefits from lower transport costs. As the NNPC subsidy occurs outside the budget, before NNPC revenues are the GON's budget revenues, there is no direct addition to the budget deficit. Obviously, however, the main short-term negative effect is that the NNPC profits could be channeled into GON budget revenue if they were not used to subsidize gasoline imports.

110. (C) There is another issue on transparency. The NNPC subsidy for gasoline is totally opaque to the general public, both amounts and process, although under EITI and the new G8 Compact the GON is committed to publishing NNPC revenues and costs. Many Nigerians assume the GON is subsidizing gasoline imports somehow, and should be subsidizing them, with the "excess crude revenues" that are the difference between the GON's budget target price of N25/bbl and the rather higher prices it is actually receiving. All of that is currently required by law to go into an escrow account the Finance Ministry must report to the National Assembly on a quarterly basis, and thus could not go toward the present gasoline subsidy which is outside the budget. National Assembly leaders have recently proposed, however, setting up a supplementary budget to fund gasoline subsidies.

POLITICALLY SUSTAINABLE?

111. (C) The long-term political effects from this course of slow and gradual deregulation by stealth may be a more serious threat to the government than to the particular policy. The complete lack of transparency in the subsidy system only adds to Nigerians' angst, as expressed in the continuing cycle of raising price, crises from opposition to raising prices, the GON appearing to retreat from raising prices, and then raising prices a few months later to begin the cycle again. Political alienation is very high, across Nigeria, and this "one step back, two steps forward" strategy adds considerably to that alienation even if it is ultimately successful in ending the gasoline subsidy.

112. (C) This cycle also plays havoc with the proper phasing and sequencing of other economic reforms. And it has virtually precluded foreign investment to bring Nigeria's

refineries back to being capable of producing Nigeria's gasoline needs, absent the GON divesting itself of all public equity in the refineries by auctioning them off to the highest bidder without insisting on a floor price. As CBN Deputy Governor Lemo noted, "We need to enlighten the public to understand that subsidizing fuel is not in their long-term interests,"

CAMPBELL